

DONALDSON CO INC  
Form 11-K  
June 29, 2007

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**FORM 11-K**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT of 1934 for the fiscal year ended December 31, 2006 or
- TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number** 1-7891

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

**DONALDSON COMPANY, INC.**

**RETIREMENT SAVINGS AND**

**EMPLOYEE STOCK OWNERSHIP PLAN**

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

DONALDSON COMPANY, INC.

1400 WEST 94TH STREET

MINNEAPOLIS, MINNESOTA 55431

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## **Donaldson Company, Inc.**

### **Retirement Savings and Employee Stock**

### **Ownership Plan**

**Financial Statements and Supplemental Schedules**

**December 31, 2006 and 2005**

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**Donaldson Company, Inc.**

**Retirement Savings and Employee Stock Ownership Plan**

**Index**

**Page(s)**

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<u>Report of Independent Registered Public Accounting Firms</u>	1
<b>Financial Statements</b>	
<u>Statements of Net Assets Available for Benefits December 31, 2006 and 2005</u>	2
<u>Statement of Changes in Net Assets Available for Benefits Year Ended December 31, 2006</u>	3
<u>Notes to Financial Statements</u>	4-7
<b>Supplemental Schedules</b>	
<u>Schedule H, line 4i Schedule of Assets (Held at End of Year) December 31, 2006</u>	8
<u>Schedule H, line 4j Schedule of Reportable Transactions Year Ended December 31, 2006</u>	9

Note: Other schedules required by 29 CFR 2520.103-10 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 have been omitted because they are not applicable.

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**Report of Independent Registered Public Accounting Firm**

To the Investment Committee and Administrator of  
Donaldson Company, Inc. Retirement Savings and Employee Stock Ownership Plan  
Minneapolis, MN

We have audited the accompanying statements of net assets available for benefits of Donaldson Company, Inc. Retirement Savings and Employee Stock Ownership Plan (the Plan) as of December 31, 2006 and 2005 and the related statement of changes in net assets available for benefits for the year ended December 31, 2006. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material

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misstatement. The Plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2006 and 2005, and the changes in net assets available for benefits for the year ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of the Plan, as listed in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental information is the responsibility of the Plan's management. The supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ Virchow, Krause & Company, LLP

Virchow, Krause & Company, LLP

Minneapolis, MN

June 26, 2007

1

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**Donaldson Company, Inc.**

**Retirement Savings and Employee Stock Ownership Plan**

**Statements of Net Assets Available for Benefits**

**December 31, 2006 and 2005**

**2006**

**2005**

**Assets**

Investments, at fair value

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Interest-bearing cash	\$ 111,083	\$ 72,976
Mutual funds	195,739,290	169,393,438
Donaldson Company, Inc. common stock fund	258,200,205	266,685,154
Participant loans	4,269,865	4,061,632
Total investments, at fair value	458,320,443	440,213,200
Receivables		
Employer contributions receivable	1,880,037	981,747
Participant contributions receivable	69,877	62,388
Total assets	460,270,357	441,257,335
Net assets available for benefits	\$ 460,270,357	\$ 441,257,335

The accompanying notes are an integral part of these financial statements.

2

**Donaldson Company, Inc.**

**Retirement Savings and Employee Stock Ownership Plan**

**Statement of Changes in Net Assets Available for Benefits**

**Year Ended December 31, 2006**

**Investment income**

Interest and dividend income	\$ 17,089,479
Net appreciation of the fair value of investments	30,777,448
	47,866,927

**Contributions**

Employer	6,872,466
Participants	12,594,006
Rollover	629,257
	20,095,729

**Deductions**

Benefits paid to participants	(48,923,069	)
Administrative expenses	(26,565	)
	(48,949,634	)

Net increase in net assets available for benefits	19,013,022
<b>Net assets available for benefits</b>	
Beginning of year	441,257,335
End of year	\$460,270,357

The accompanying notes are an integral part of these financial statements.

3

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## **Donaldson Company, Inc.**

### **Retirement Savings and Employee Stock Ownership Plan**

#### **Notes to Financial Statements**

#### **December 31, 2006 and 2005**

##### **1. Description of the Plan**

The Donaldson Company, Inc. Retirement Savings and Employee Stock Ownership Plan (the Plan) is a contributory defined contribution plan sponsored by Donaldson Company, Inc. (the Company). The Plan is subject to the applicable provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

The following description of the Plan is provided for general information purposes only. Participants should refer to the summary plan description for a more complete description of the Plan's provisions.

Fidelity Management Trust Company is the Plan's trustee (the Trustee) and recordkeeper.

##### **Eligibility**

All regular full-time and part-time employees are eligible to participate in the Plan upon employment, as defined by the Plan document. Employees covered by a labor agreement are not eligible for any Company contributions.

## **Contributions**

Each year, eligible participants may contribute to the Plan up to 25% of pre-tax annual compensation, as defined by the Plan. Participants may also contribute amounts representing rollover distributions from other qualified retirement plans with the approval of the Administrative Committee. Participants over age 50 may contribute an additional catch up contribution.

Under the terms of the Plan, the Company makes fixed matching contributions and could make discretionary contributions to the Plan. Company contributions are made in cash or through submission of shares of common stock of the Company. Any cash contributions are invested directly in common stock of the Company.

The Company made matching fixed contributions to the Plan based on participant contributions into the Plan. Fixed matching contributions were calculated at 100% of up to 3% of compensation deferred by the participant and deposited into the Plan and 50% of the next 2% of compensation deferred by participants and deposited into the Plan.

The Company may make discretionary contributions to the Plan from time to time. Discretionary contributions are allocated among the participants pro rata based upon the total annual compensation of participants who have 1,000 hours of service in the Plan year and are in employment of the Company on the last day of the Plan year. Subsequent to each Plan year end, the Company made a discretionary contribution of \$1,575,389 and \$740,637 for the Plan years ended December 31, 2006 and 2005, respectively.

## **Participant Accounts**

Participants direct the investment of their contributions into various investment options offered by the Plan. If a participant does not allocate their contributions, the contributions are placed in the Fidelity Managed Income Portfolio II Fund. Company contributions are allocated in the Donaldson Company, Inc. common stock fund.

The allocation of the participant's contributions to the investment funds may be changed daily. There are no restrictions on transfers among or between the various investment options for employee contributions. Each participant's account is credited with his or her contributions, including rollover distributions, and his or her share of Company contributions, and an allocation of related investment earnings thereon. Allocation of investment earnings is based on the value of the participant's account at the close of each day. Participants can transfer Company contributions out of Donaldson Company, Inc. common stock fund to other investment funds after they have five years of service with the Company. Effective March 31, 2006 the Plan was amended to allow participants to transfer Company contributions out of Donaldson stock at any time.

4

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## **Donaldson Company, Inc.**

### **Retirement Savings and Employee Stock Ownership Plan**

#### **Notes to Financial Statements**

**December 31, 2006 and 2005**

**Vesting**

Participants are 100% vested in their accounts at all times.

**Payment of Benefits**

Upon termination of employment, disability or termination of the Plan, a participant or designated beneficiary will receive the vested portion of the participant's account balance in a lump-sum payment. Hardship withdrawals, as defined in the Plan document, are allowed at any time, subject to approval by the Plan.

**Participant Loans**

Under the Plan document, participants may borrow up to 50% of their account balance or \$50,000, whichever is less. Loans must be repaid by the participant within five years, unless the loan is used to acquire the participant's primary residence in which case the term may not exceed ten years. The loan interest is one percent over the prime lending rate on the first day of the Plan year (January 1) coinciding with the year in which the loan is granted. Interest rates on outstanding loans at December 31, 2006, ranged from 5% to 10.5%. Loans mature at various dates through August 2016 and are generally paid through payroll deductions.

**Plan Termination**

The Company has the right under the Plan agreement to amend or terminate the Plan. In the event of termination of the Plan, the assets of the Plan will be distributed to the participants in accordance with the Plan document.

**2. Summary of Significant Accounting Policies**

The accompanying financial statements have been prepared on an accrual basis. The following is a summary of significant policies which are in conformity with accounting principles generally accepted in the United States of America and are consistently followed by the Plan in the preparation of its financial statements.

**Valuation of Investments**

Investments in mutual funds are stated at fair value based on quoted market prices. Investments in the Donaldson Company, Inc. common stock fund are valued based on the fair value of the underlying investments, primarily Donaldson Company, Inc. common stock, which is valued at quoted market prices. Investments in the common / collective trust are valued at contract value, which approximates fair value. Participant loans are valued at estimated fair value, which consists of outstanding principal and any related accrued interest.

**Investment Earnings**

Investment income is recorded as earned. Dividend income is recorded on the ex-dividend date. The Plan presents the net appreciation in the fair value of its investments in the Statement of Changes in Net Assets Available for Benefits. Net appreciation consists of the realized gains or losses and the unrealized appreciation (depreciation) on those investments.



### **Contributions**

Participant contributions and Company matching contributions are recorded in the period the employer makes the payroll deductions. Company discretionary contributions, if any, are recorded in the period which they were declared.

### **Benefits Paid to Participants**

Benefits paid to participants are recorded when paid.

5

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## **Donaldson Company, Inc.**

### **Retirement Savings and Employee Stock Ownership Plan**

#### **Notes to Financial Statements**

**December 31, 2006 and 2005**

#### **Plan Expenses**

Investment management fees and administrative fees charged by the Trustee are paid by the Plan. All other expenses are paid by the Company, including legal, accounting and other services.

#### **Use of Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of net assets available for benefits at the date of the financial statements and the reported amounts of changes in net assets available for benefits during the reporting period. Ultimate results could differ from those estimates.

#### **Risks and Uncertainties**

The Plan provides for various investment options in various combinations of investment securities. Investment securities are exposed to various risk factors including, but not limited to, interest rates, market conditions and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the Statement of Net Assets Available for Benefits in future periods.

**Concentration of Market Risk**

At December 31, 2006 and 2005, approximately 56% and 60% of the Plan's net assets available for benefits were invested in the Donaldson Company, Inc. common stock fund, respectively. The underlying value of this fund is dependent on the performance of Donaldson Company, Inc. and the market's evaluation of such performance. It is at least reasonably possible that changes in the fair value of Donaldson Company, Inc. common stock in the near term could materially affect participants' account balances and the amounts reported in the Statement of Net Assets Available for Benefits and the Statement of Changes in Net Assets Available for Benefits in future periods.

**3. Investments**

The current values of individual investments that represent 5% or more of the Plan's net assets available for benefits were as follows as of December 31, 2006 and 2005, respectively:

	<b>2006</b>	<b>2005</b>
Donaldson Company, Inc. common stock fund	\$258,200,205	\$266,685,154
Fidelity Equity Income Fund	42,355,898	37,297,675
Fidelity Managed Income Portfolio II Fund	39,723,692	38,752,376
Fidelity Contrafund	26,404,414	24,057,823

During the year ended December 31, 2006, investments had net appreciation in value as follows:

Net appreciation of Mutual funds	\$5,859,079
Net appreciation of Donaldson Company, Inc. common stock	24,918,369
	<b>\$30,777,448</b>

At December 31, 2006, the Donaldson Company, Inc. common stock fund consisted of 7,418,687 of the Company's common stock valued at \$257,502,625 and \$697,580 which consists mainly of cash in the Fidelity Institutional Cash Portfolio. At December 31, 2005, the Donaldson Company, Inc. common stock fund consisted of 8,367,849 shares of the Company's common stock valued at \$266,097,598 and \$587,556 of cash in the Fidelity Institutional Cash Portfolio.

**Donaldson Company, Inc.**

**Retirement Savings and Employee Stock Ownership Plan**

**Notes to Financial Statements**

**December 31, 2006 and 2005**

**4. Nonparticipant-Directed Investments**

Information about the net assets available for benefits and the significant components of the changes in net assets available for benefits relating to the nonparticipant-directed investments is as follows:

	<b>2006</b>	<b>2005</b>
Donaldson Company, Inc. common stock fund Nonparticipant-Directed	\$ 205,374,925	\$ 214,432,304
Donaldson Company, Inc. common stock fund Participant-Directed	52,825,280	52,252,850
Total Donaldson Company, Inc. common stock fund	\$ 258,200,205	\$ 266,685,154

	<b>Year ended December 31, 2006</b>
Changes in Nonparticipant-Directed Net Assets of Donaldson Company, Inc. Common stock fund:	
Contributions	\$5,974,176
Interest and dividend income	1,127,504
Net appreciation	19,461,565
Benefits paid to participants	(21,713,065 )
Transfers to participant-directed investments	(13,907,559 )
	\$(9,057,379 )

**5. Tax Status**

The Plan has received a favorable determination letter from the Internal Revenue Service, dated September 20, 2002, stating that the Plan is designed in accordance with the applicable sections of the Internal Revenue Code (the Code) and is therefore generally exempt from federal income taxes under provisions of Section 501(a). The Plan has been amended since receiving the determination letter. However, the Plan administrator believes that the Plan is currently designed and being operated in compliance with the applicable requirements of the Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

**6. Related Party Transactions**

Participants have the option to direct their contributions to be invested in mutual funds which are sponsored by the Trustee and a Company stock fund comprised primarily of Donaldson Company, Inc. common stock. The Trustee is authorized, under contract provisions and by exemption under 29 CFR 408(b) of ERISA regulations, to invest in securities under its control and in the Company. For the year ended December 31, 2006, purchases and sales of securities of the Company were \$73,327,555 and \$105,712,092 respectively.

7

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**SUPPLEMENTAL SCHEDULES**

**Donaldson Company, Inc.****Retirement Savings and Employee Stock Ownership Plan****Schedule H, line 4i Schedule of Assets (Held at End of Year)****December 31, 2006****EIN 41-0222640****Plan Number 007**

(a) (b) Identity of Issue, Borrower, Lessor or Similar Party	(c) Description of Investment Including the Maturity Date, Rate of Interest, Collateral, Par or Maturity Value	(d) Cost	(e) Current Value
* Donaldson Company, Inc. Common Stock Fund	Common Stock, 7,418,687 shares participation	\$ 62,151,741	** \$258,200,205
* Fidelity Equity Income Fund	Mutual Fund, 723,414 units of participation	**	42,355,898
* Fidelity Managed Income Portfolio II Fund	Common / Collective Trust, 39,723,692 units of participation	**	39,723,692
* Fidelity Contrafund	Mutual Fund, 404,976 units of participation	**	26,404,414
* Fidelity Diversified International Fund	Mutual Fund, 509,268 units of participation	**	18,817,461
* Fidelity Magellan Fund	Mutual Fund, 192,317 units of participation	**	17,216,298
* Fidelity Balanced Fund	Mutual Fund, 692,188 units of participation	**	13,449,207
Schroeder U.S. Opportunities Fund	Mutual Fund, 593,891 units of participation	**	13,035,913
Spartan US Equity Index Fund	Mutual Fund, 127,945 units of participation	**	6,420,273
WFA Small Company Value Fund	Mutual Fund, 220,883 units of participation	**	3,492,162
PIMCO Total Return Fund	Mutual Fund, 402,848 units of participation	**	4,181,560
Brokeragelink Fund	Mutual Fund, 2,205,969 units of participation	**	2,205,969
Roxbury Small Cap Growth Fund	Mutual Fund, 39,951 units of participation	**	757,476
Chesapeake Core Growth Fund	Mutual Fund, 39,554 units of participation	**	714,746
* Fidelity Ret Govt MM Fund	Mutual Fund, 22 units of participation	**	22

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* Fidelity Freedom Income Fund	Mutual Fund, 23,034 units of participation	**	265,811
* Fidelity Freedom 2010 Fund	Mutual Fund, 64,508 units of participation	**	943,109
* Fidelity Freedom 2020 Fund	Mutual Fund, 88,745 units of participation	**	1,378,212
* Fidelity Freedom 2030 Fund	Mutual Fund, 44,345 units of participation	**	710,843
* Fidelity Freedom 2040 Fund	Mutual Fund, 53,049 units of participation	**	502,900
* Fidelity Freedom 2005 Fund	Mutual Fund, 18,521 units of participation	**	215,031
* Fidelity Freedom 2015 Fund	Mutual Fund, 111,031 units of participation	**	1,354,583
* Fidelity Freedom 2025 Fund	Mutual Fund, 106,334 units of participation	**	1,357,879
* Fidelity Freedom 2035 Fund	Mutual Fund, 26,301 units of participation	**	346,914
* Participant Loans	Participant loans receivable, interest rates from 5% to 10.5%, payable through August 2016		4,269,865
			\$458,320,443

\* Denotes party-in-interest.

\*\* Historical cost information is omitted as it is not required by the Department of Labor under the instructions to the Form 5500 for participant directed accounts. The Donaldson Company, Inc. Common Stock Fund includes Nonparticipant-directed investment cost of \$39,908,010.

8

**Donaldson Company, Inc.**

**Retirement Savings and Employee Stock Ownership Plan**

**Schedule H, line 4j Schedule of Reportable Transactions**

**Year Ended December 31, 2006**

**EIN 41-0222640**

**Plan Number 007**

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
Identity of Party Involved	Description of Assets	Purchase Price	Selling Price	Lease Rental	Expense Incurred With Transaction	Cost of Asset	Current Value of Asset on Transaction Date	Net Gain

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* Donaldson Company	Common Stock Fund	\$	\$37,629,510	\$	\$	\$8,421,492	\$37,629,510	\$29,208,018
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\* Denotes party-in-interest.

9

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

DONALDSON COMPANY, INC. RETIREMENT  
SAVINGS AND EMPLOYEE STOCK  
OWNERSHIP PLAN  
(Name of Plan)

Date June 26, 2007

By: Donaldson Company, Inc., the Plan Administrator

By: /s/ Thomas R. VerHage  
Thomas R. VerHage  
Vice President, Chief Financial Officer

**EXHIBIT INDEX**

**ANNUAL REPORT ON FORM 11-K**

Exhibit 23.1      Consent of Independent Registered Public Accounting Firm